United States Court of Appeals

for the Second Circuit

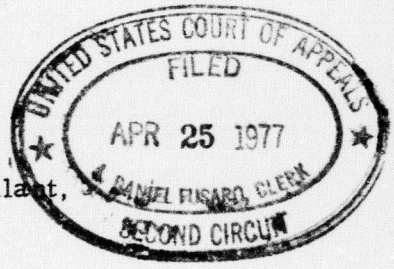
BRIEF FOR APPELLANT

76-7627

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT



STEVEN PAUL KESSLER,

Plaintiff-Appellant,

v.

LAWRENCE A. WIEN, et al.,

Defendants-Appellees.

Appeal from the United States District Court
for the Southern District of New York

BRIEF FOR APPELLANT

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INDEX

Page

Preliminary Statement 1

Issue Presented 2

Statement of the Case 3

Argument -

A security holder who brings a class suit alleging that a proxy statement is misleading is not rendered an inadequate class representative merely because his fellow holders were misled by the very proxy statement which he is challenging--and voted differently than he did . . . 5

Conclusion 12

TABLE OF CASES

Basch v. Talley Industries, Inc., 53 F.R.D. 14 (S.D.N.Y. 1971). 7

Civen v. Countrywide Realty, Inc., [74-75] CCH Fed. Sec. L. Rep ¶95,037 (S.D.N.Y. 1975). 9, 10

Dann v. Studebaker-Packard Corp., 288 F.2d 201, 207 (6th Cir. 1961) 9

duPont v. Perot, 59 F.R.D. 404, 411 (S.D.N.Y. 1973) 11

Free World Foreign Cars, Inc. v. Alfa Romeo, S.p.A., 55 F.R.D. 26, 28 (S.D.N.Y. 1972) 11

Gerstle v. Gamble-Skogmo, Inc., 298 F.Supp. 66 (E.D.N.Y. 1969, aff'd 478 F.2d 1281 (2d Cir. 1973) 7

Gerstle v. Gamble-Skogmo, Inc., supra and 32 F. Supp. 644 (E.D.N.Y. 1971) and 348 F. Supp. 979 (E.D.N.Y. 1972) 8

Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968) 10

Korn v. Franchard Corp., 456 F.2d 1206 (2d Cir. 1972) 10

Page

Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970) 8

Northern Acceptance Trust 1065 v. AMFAC, Inc., 51 F.R.D. 487 (D.C.Hawaii 1971) 9

Popkin v. Wheelabrator-Frye, Inc., [73] CCH Fed. Sec. L. Rep. ¶94,091, at p. 94,372 (S.D.N.Y. 1974) 9

Sirota v. Econo-Car International, Inc., 61 F.R.D. 604 (S.D.N.Y. 1974) 9

Smallwood v. Pearl Brewing Co., 489 F.2d 579 (5th Cir. 1974) . . 9

Weisfeld v. Spartans Industries, Inc., 58 F.R.D. 570 (S.D.N.Y. 1972) 9

Weisman v. MCA, Inc., 45 F.R.D. 258 (D.C.Del. 1968) 9

PRELIMINARY STATEMENT

Plaintiff appeals from the denial by the district court Honorable Richard Owen, U.S.D.J., of his motion for class certification in a proxy violations case.

The alleged wrong is based on the mailing of a single solicitation letter to all the members of the proposed class. Plaintiff claims the letter failed to make the required disclosures.

The district court denied class treatment for a single reason: 88 percent of the recipients of the challenged letter voted in favor of the proposed transaction. Therefore the district court reasoned that there was a conflict of interest between plaintiff and his fellow class members because they voted in favor of a transaction he opposed. From this the court concluded that plaintiff's claim was not typical of the claims of the class, and being antagonistic, plaintiff could not adequately represent the class as required by Rule 23(a)(3) and (4), F.R.Civ.P.

The district court's reasoning is erroneous, and has been consistently rejected by the courts. If the soliciting letter was misleading, it misled those who voted in favor. Defendants should not be permitted through their guile to avoid class certification--which is an effective judicial technique for protecting the entire injured class in the event of a recovery. Such a result would mean the more misleading the proxy statement, the less likely an action could be maintained as a class action.

ISSUE PRESENTED

Where a security holder brings a class suit alleging that a proxy statement is misleading, does the fact that his fellow holders voted in favor of a transaction he opposed--as a result of the allegedly defective proxy statement--render him an inadequate class representative and his claim atypical?

The district court held it does

STATEMENT OF THE CASE

This action is based on a letter sent by defendants to participants in 250 West 57th Street Associates (Associates) soliciting their consents to modifications in the net lease and mortgage of an office building to which Associates, a publicly held joint venture, held title. The letter was mailed April 10, 1975. (A-87)

Plaintiff Steven Kessler, a participant in Associates, filed his complaint on April 18, 1975, alleging violations of the federal securities laws, the corresponding state law provisions and common law.

Defendants are the original promoters and operators of the joint venture, holding a net lease from Associates. The defendants operate through a private partnership known as Fisk Building Associates (Fisk). Some of the defendants are the law firm and its partners which represent both Associates, Fisk and the promoter-operators. An amended complaint was filed May 15, 1975. (A-5)

Plaintiff sought a preliminary injunction restraining consummation of the lease and mortgage transactions, and the district court denied the motion on May 23, 1975 on the ground that defendants could adequately respond in damages, and there was no irreparable harm to plaintiff. (A-135; A-117, 124, 127, 132)

Defendants moved to dismiss the complaint prior to discovery, plaintiff cross-moved for summary judgment as to

Count 1 (alleging that the April 10 letter constituted the offering of a new security, subject to registration) and for class certification. (A-159)

Counsel for all defendants other than Associates wrote the Court on November 11, 1975 requesting that the Court defer consideration of the class motion until defendants' motions to dismiss had been decided for the reason that defendants wished to conduct discovery on the class issue. (A-165) The Court deferred the class motion as requested.

On May 14, 1976, the district court, Honorable Richard Owen, U.S.D.J., in a memorandum opinion granted defendants' motions to dismiss Counts 1 and 2, but denied the motion as regards the other counts, including the proxy violation count (Count 6). (A-167)

Plaintiff promptly renewed his motion for class certification on May 20, 1976. (A-179)

Although defendants obtained several extensions of the return date on the class motion, no discovery was conducted by them. Specifically, they failed to take plaintiff's deposition.

On November 16, 1976, the district court, Honorable Richard Owen, U.S.D.J., in a memorandum opinion and order denied plaintiff's class motion. (A-185)

This appeal was noticed on December 10, 1976. (A-187)

ARGUMENT

A security holder who brings a class suit alleging that a proxy statement is misleading is not rendered an inadequate class representative merely because his fellow holders were misled by the very proxy statement which he is challenging--and voted differently than he did.

Proxy suits, like prospectus suits, are classic fact patterns in federal securities litigation for class treatment. This is because in both cases all the members of the class received the same document, and this document in turn is the vehicle by which the wrong is alleged to have been committed.

This case turns on the mailing of a single proxy statement--a letter dated April 10, 1975.[1] The letter was filed with the Securities and Exchange Commission (SEC) as a proxy solicitation. The letter sought the consent of plaintiff and other holders of security interests of a limited partnership nature (Interests) in a publicly held real estate syndication, 250 West 57th Street Associates (Associates), to modifications in the net lease of Associates' sole asset, a building located in New York City.

Plaintiff alleges that the April 10 letter omitted necessary material facts about the promoter-managers of the syndicate, specifically, conflicts of interest and self-dealing on their part. (The promoter-managers through a private partnership, Fisk Building Associates (Fisk), hold the net lease from the public venture, Associates, and operate both the building and the syndicate without any supervision by the holders of Interests.

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[1]Letter dated April 10, 1975, attached as Exhibit G to Wien Affidavit of May 22, 1975 (A-87)

The district court denied class treatment for a single reason: 88 percent of the recipients of the challenged proxy statement voted in favor of a transaction which plaintiff opposed, that is, 88 percent gave their consent to consummation of the lease modification transaction between Associates and the net lessee, Fisk.

The learned district judge stated his reasoning succinctly:

> Approximately 88% of the proposed class have given their approval to the April 10, 1975 proposal, the very proposal upon which plaintiff bases his SEC proxy rule violation. Where such a percentage of the potential class members have so voiced their disagreement with plaintiff's course of action, if allowed to represent the class, plaintiff would be in a position to overturn the will of the vast majority. This conflict of interest prevents plaintiff from adequately representing the proposed class.[2]

It is undisputed that plaintiff's objection to the proxy statement has never been communicated to his 500 fellow holders who constitute the proposed class. They will only learn that the April 10 letter is allegedly defective if class treatment is allowed and they are given notice of the existence of this action. Such notice will also permit plaintiff's fellow holders to opt out if they desire.

It is also important to note that since the security at issue here is in a joint venture which does not hold corporate meetings of holders of Interests, plaintiff had no opportunity to voice his objections in a physical meeting of holders of Interests. The district court refused to enjoin consummation of the transaction in question on the ground that there would be no irreparable injury

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[2]Memorandum and Order dated November 16, 1976, p. 2. (A-186)

to plaintiff.[3]

The reasoning of the district court is erroneous, and has been consistently rejected by the courts. In Basch v. Talley Industries, Inc., 53 F.R.D. 14 (S.D.N.Y. 1971), the court pointed out that the claims of a recipient of a proxy solicitation are claims typical of the class of all recipients, stating:

> The legal and factual issue will turn upon the alleged misrepresentations and omissions in the specific proxy statement used for solicitation of proxies for the merger meeting. Since this is a single document applicable to all GTC shareholders it is clear that the questions of law and fact are common to the entire class and the plaintiffs, as recipients of the proxy statement, have claims typical of the class. Id. at 18.

The court went on to state that plaintiff's claims were typical of the class whether or not he voted for or against the resolution which was subject to the proxy:

> There is generally no conflict of interest among the shareholders who exchanged their stock under the merger plan which resulted from an alleged false and misleading proxy statement. All are similarly situated. . . . It does not matter how the particular plaintiffs voted. What matters is that deception practiced on other GTC shareholders to induce them to vote for the merger would be sufficient to create liability. Ibid.

In Gerstle v. Gamble-Skogmo, Inc., 298 F.Supp. 66 (E.D.N.Y. 1969), aff'd 478 F.2d 1281 (2d Cir. 1973), a shareholder who alleged that he was misled by a proxy statement was allowed to represent the class who received the proxy statement, notwithstanding the fact that more than two-thirds of the class approved the action which the share-

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[3]See remarks of Judge Owen in transcript of hearing on preliminary injunction motion held May 23, 1975, at p. 25. (A-135)

holder was challenging. The court held that "[t]he appropriate class of stockholders includes all those who were injured because of the false or misleading statements injected in the proxy material. . . ." Id. at 103. The court indicated that:

> The rights of those who voted for the merger because of misrepresentations and of those who may not have been misled into voting for the merger are essentially the same. The breach of duty in both cases is the same. The proof required to establish the right by either class of stockholders is identical. . . . Id. at 103.

In affirming the district court's award of damages to the plaintiff class in Gerstle v. Gamble-Skogmo, Inc., supra and 32 F. Supp. 644 (E.D.N.Y. 1971) and 348 F. Supp. 979 (E.D.N.Y. 1972), Chief Judge Friendly implicitly approved class treatment:

> We thus hold that in a case like this, where the plaintiffs represent the very class who were asked to approve a merger on the basis of a misleading proxy statement and are seeking compensation from the beneficiary who is responsible for the preparation of the statement, they are not required to establish any evil motive or even reckless disregard of the facts. Id., 478 F.2d at 1300-130.

This is the same problem as in the case at bar. In both cases the transaction has been consummated and the plaintiffs ask either rescission or damages. Rather than seeking to "unscramble the eggs from the omelette" by way of rescission, the Gerstle court awarded damages, and this Court affirmed. This followed a suggestion in Mills v. Electric Auto-Lite Co., 396 U.S. 375, (1970), of Justice Harlan that "nothing in the statutory policy 'requires the court to unscramble a corporate transaction merely because a violation occurred.'"

Thus if the district court in the case at bar were to order damages rather than rescission of the now consummated transaction class treatment is necessary to assure that all the class members receive such damages as are awarded.

Other courts have held that a plaintiff is not disqualified as a class representative by the fact that his fellow security holders voted differently on the challenged matter. Dann v. Studebaker-Packard Corp., 288 F.2d 201, 217 (6th Cir. 1961); Smallwood v. Pearl Brewing Co., 489 F.2d 579 (5th Cir. 1974)(shareholder permitted to represent class in which vote was 1,253,337 to 235,449); Popkin v. Wheelabrator-Frye, Inc., [73] CCH Fed. Sec. L. Rep. ¶ 94,091, at p. 94,372 (S.D.N.Y. 1973)(shareholder permitted to represent class in merger vote which was overwhelmingly approved); Weisfeld v. Spartans Industries, Inc., 58 F.R.D. 570 (S.D.N.Y. 1972) (shareholder permitted to represent class in which 98% voted for the merger); cf. Weisman v. MCA, Inc., 45 F.R.D. 258 (D. C.Del. 1968); Northern Acceptance Trust 1065 v. AMFAC, Inc., 51 F.R.D. 487 (D.C.Hawaii 1971); Sirota v. Econo-Car International, Inc., 61 F.R.D. 604 (S.D.N.Y. 1974).

Interestingly, the district judge himself rejected the precise reasoning he employed in this case in an earlier decision. Civen v. Countrywide Realty, Inc., [74-75] CCH Fed. Sec. L. Rep. ¶ 95,037 (S.D.N.Y. 1975)(Owen, J.). In Civen, Judge Owen first set forth the established view regarding securities class actions where a single document was sent to each member

of the proposed class:

> Since the legal and factual issues raised by [plaintiff's] complaint are based upon the alleged omissions embodied within one specific proxy statement applicable to all members of the class, there is presented a classic situation for the declaration of a class which does not need discussion. Id. at p. 97,758.

Defendants had raised the same objection that plaintiff's claim was atyp cal in Civen, and that plaintiff was therefore an inadequate representative of the proposed class. Indeed, Judge Owen noted that "Judge Ryan denied the Civen class motion partially for this reason." Id. at 97,759. Then, Judge Owen rejected the very logic which he later advanced in the instant appeal:

> However, since Judge Ryan's early ruling in the Civen action, several cases have indicated that in a situation where a proxy statement with a material omission induces shareholders to vote for a merger, defendants are liable to all shareholders alike irrespective of their vote on the merger question for the inadequate consideration paid for the assets of their company and all shareholders may be represented by one shareholder irrespective of whether or how he voted. [Citations omitted]. Ibid.

Judge Owen did not state why he again changed his mind in the instant appeal.

The cases cited by the lower court are not apposite. In Korn v. Franchard Corp., 456 F.2d 1206 (2d Cir. 1972), the plaintiff was allowed to represent all purchasers of units in a limited partnership even though while the action was pending most of the purchasers signed releases but the plaintiff did not. In Green v. Wolf Corp., 406 F.2d 291

(2d Cir. 1968), the plaintiff, who purchased shares after a third prospectus, was allowed to represent purchasers who purchased after the first and after the second, but before the third, prospectus. In Free World Foreign Cars, Inc. v. Alfa Romeo, S.p.A., 55 F.R.D. 26, 28 (S.D.N.Y. 1972), cited by the lower court, plaintiff was held not to be a class representative because "as a former franchisee, [it] is not a member of a class of present franchisees. Nor is it an adequate representative to protect their interest." (Emphasis supplied). In duPont v. Perot, 59 F.R.D. 404, 411 (S.D.N.Y. 1973), over ninety percent of the proposed class, but not plaintiff, had signed releases, and accordingly, the plaintiff was held not an adequate representative of the ninety percent since he "is obviously indifferent as to whether the releases are rescinded or affirmed."

If the proxy statement in the case at bar was misleading, it misled those who voted in favor of the transaction. Defendants should not be permitted through their guile to avoid class certification. Such a result would mean the more misleading the proxy statement, the less likely an action could be maintained as a class action.

CONCLUSION

The order of the district court denying plaintiff's motion for class certification should be reversed.

Dated: New York, New York
February 14, 1977

Respectfully submitted,

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